

**MINUTES OF THE REGULAR MEETING OF THE
ARIZONA STATE RETIREMENT SYSTEM BOARD**

**HELD ON
October 15, 2004
8:30 a.m., MST**

The Arizona State Retirement System (ASRS) Board met in the 10th Floor Board Room, 3300 N. Central Avenue, Phoenix, Arizona. Dr. Keith Meredith, Chairperson of the ASRS Board, called the meeting to order at 8:33 a.m., MST.

The meeting was teleconferenced to the ASRS office at 7660 E. Broadway, Tucson, Arizona 85710.

1. Call to Order; Roll Call; Opening Remarks

Present: Dr. Keith Meredith, Chairperson
Mr. Karl Polen, Vice Chairperson
Ms. Charlotte Borchert
Mr. Jim Bruner
Mr. Jaime Gutierrez
Mr. Michael Townsend
Mr. Lawrence Trachtenberg
Mr. Steven Zeman

Absent: Ms. Anne Mariucci

A quorum was present for the purpose of conducting business.

2. Approval of the Consent Agenda

Motion: Mr. Jim Bruner moved to approve Refunds, Death Benefits, and System Transfers,

And

Approve of Applications and Agreements with the following Employers:

- Central AZ Assoc. of Governments (CAAG)
- Pima Assoc. of Governments (PAG)
- Akimel O’Otham Pee Posh Charter School dba Blackwater Community School (3-4)
- Akimel O’Otham Pee Posh Charter School dba Blackwater Community School (K-2)

And

Approve the minutes of the September 17, 2004, regular meeting of the ASRS Board,

And

Approve the recommended administrative law judge's decision regarding Darcy L. Forst.

Mr. Jaime Gutierrez seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, and 1 excused, the motion was approved.

Mr. Dale Norris, Attorney representing Darcy Forst, addressed the Board regarding Ms. Forst's appeal. He requested that the Board modify the Office of Administrative Hearing's findings and award Ms. Forst the contributions not withheld for the years she requested.

Mr. Thomas Arn, Attorney for the Peoria Unified School District, addressed the Board. He stated that all information was presented to the Office of Administrative Hearings (OAH) and OAH's decision should be approved.

3. Presentation, Discussion and Appropriate Action Regarding the Notice of Emergency Rulemaking for Actuarial Present Value Calculations for Service Purchase

Ms. Susanne Dobel, External Affairs Manager, explained there is a request for an Emergency Rulemaking for actuarial present value calculations for service purchase because HB 2029, the law that changes how the cost is calculated for ASRS members went into effect on August 25, 2004. Specifically, under the prior law, the members paid a "normal cost" for service being purchased. Under the new law, the cost to the member would be calculated at the actuarial present value of the purchased benefit, specific to the member making the purchase.

This emergency rulemaking specifies how the actuarial present value is calculated, which types of service credit are calculated using the actuarial present value, and limits the number of requests to purchase service credit that are active at any given time.

Motion: Mr. Jaime Gutierrez moved to approve the Notice of Emergency Rulemaking for actuarial present value calculations for service purchases.

Mr. Steven Zeman seconded the motion.

By a vote of 7 in favor, 0 opposed, 0 abstentions, and 2 excused, the motion was approved.

Mr. Lawrence Trachtenberg arrived at the meeting.

4. Presentation, Discussion and Appropriate Action Regarding the Actuarial Audit Report of the LTD Plan

Per Ms. Charlotte Borchert, Chairperson, Operations Review Committee (ORC), the ORC met on October 8, 2004, to discuss the Actuarial Audit Report of the LTD Plan provided by Milliman

Consultants and Actuaries (Milliman). In its most significant finding, Milliman viewed the cost method, used by Mellon Human Resources & Investor Solutions (Mellon) to calculate contributions, as inconsistent with the financial objectives and statements listed in the ASRS Comprehensive Annual Financial Report (CAFR). Milliman called upon the ASRS to implement a more conservative method for determining contributions, with the result being fewer liabilities amortized, and higher contributions overall.

Ms. Borchert stated that through the discussions during the ORC meeting, it was discovered that Milliman was using the CAFR and that the statements in the CAFR have not been revised recently, or directly tied to the LTD Plan. To address these concerns the ORC recommends that staff review methodologies and objectives used in its valuations and report conclusions and make recommendations for appropriate action. Staff should also insure adequate disclosure of major assumptions, methods and changes in the CAFR and actuarial valuations.

Further, the ORC recommends the following based on the Milliman report:

- The ASRS actuary should use the 2006 Experience Study to recommend whether or not to recognize social security offsets in order to lower open claim offsets. These changes should be recognized in the 2006 valuation.
- The ASRS actuary should review annual experience and recommend whether experience or a manual method should be used to determine "Incurred But Not Open" reserves. These changes should be recognized in the 2006 valuation.
- VPA should correct data related to "date of hire" so that the ASRS actuary may make use of it in future valuations.
- The ASRS actuary should begin measuring claim termination experience.
- The ASRS actuary should calculate a claim administrative expense reserve.

After some discussion regarding the seriousness of the conclusions presented in the Milliman report, Mr. Karl Polen requested a clear deadline for a follow up report on the appropriateness of methods used to fund the LTD Plan.

Motion: Mr. Polen moved to review methodologies and objectives to make recommendations for appropriate action to insure an actuarially sound approach to funding the LTD Plan. This process should be completed within six months.

Mr. Jim Bruner seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, and 1 excused, the motion was approved.

5. Presentation, Discussion and Appropriate Action Regarding the Actuarial Audit Report for the Plan's Pension Benefits

Milliman provided an actuarial audit report of the Pension Plan. Milliman found no major issues in its review of Mellon's work. Among its comments, Milliman found that calculations were accurate and consistent, contribution rates generally provided appropriate funding levels for benefits, and assumptions were reasonable.

Some modest issues were raised and the ORC made recommendations as follows:

- Staff should study the PBI program, review options for providing a better, cost neutral mechanism for increasing retired members benefits, and make recommendations prior to the 2006 valuation.
- The ASRS actuary should revise the application of its salary scale consistent with Milliman's recommendation. Staff may link and implement this change with other assessments being undertaken by the director to review pension plan design and methodology.
- Future valuations should reflect the delay in implementing new contribution rates. Staff may link and implement this change with other assessments being undertaken by the director to review pension plan design and methodology.
- The ASRS actuary should correct mislabeled data related to the rural health insurance enhanced subsidy.
- The ASRS should correct coding related to valuing health supplements for inactive members.
- The ASRS actuary should correct information on dependent date of birth.
- The ASRS actuary should make projections, for current active members who are assumed to go out on LTD and are not yet eligible for retirement, by calculating average age at the expected pension commencement for all current disabled members.

Motion: Mr. Michael Townsend moved to adopt the recommendations of the Operations Review Committee to address findings related to actuarial services for the Pension Plan.

Mr. Steven Zeman seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, and 1 excused, the motion was approved.

6. Presentation, Discussion and Appropriate Action Regarding the Term of the Current Actuarial Contract and the Extension of the Time Period to Award the New Actuarial Contract

Motion: Mr. Jim Bruner moved to postpone the award of the actuary contract.

And

Moved to direct ASRS staff to request an extension of the current actuary contract until June 30, 2005.

By a vote of 8 in favor, 0 opposed, 0 abstentions, and 1 excused, the motion was approved.

Ms. Charlotte Borchert departed the meeting.

7. Presentation, Discussion and Appropriate Action Regarding ASRS' Global Tactical Asset Allocation Program

Mr. Gary Dokes, Chief Investment Officer, Mr. Michael Viteri, Equity Portfolio Manager, Mr. Daniel Kapanak, Senior Portfolio Analyst, and Mr. Terry Dennison, Mercer Investment Consulting presented the annual formal ASRS Global Tactical Asset Allocation (GTAA) review.

As of September 30, 2004, the combined market value of ASRS GTAA manager(s) was \$2.1 billion, or 10.1% of the ASRS total assets. Both GTAA managers have an inception date of December 31, 2003, and a benchmark of 56% S&P500, 16% MSCI EAFE, and 28% Lehman Brothers Aggregate which is the ASRS Total Fund policy benchmark with 6% real estate prorated.

8. Presentation, Discussion and Appropriate Action Regarding ASRS' Real Estate Owned/Occupied Properties

Mr. Gary Dokes, Mr. Cesar Porte, Real Estate Portfolio Analyst, and Mr. Eric Rovelli, Assistant Equity/Real Estate Portfolio Analyst presented on the ASRS Real Estate owned/occupied properties. In their presentation they discussed property profiles, comparative market information, property performance, offers to purchase portions of ASRS land, and future management of ASRS real estate owned/occupied properties.

9. Presentation, Discussion and Appropriate Action Regarding Possible Legislative Issues for the 2005 Legislative Session

Ms. Denisse Gee, Government Relations Officer, explained that there are two issues before the Board. The first issue is with regard to the pop up/pop down benefit. Statute currently allows a retired member who has selected a period-certain or joint and survivor annuity at the time of retirement to "pop-up" to a straight life annuity and then "pop-down," returning to the initial annuity choice as many times as a member chooses, with no restrictions. This results in an actuarial cost to the fund because these members have received a joint and survivor annuity without paying for such benefits via a reduced monthly annuity.

The second issue is with regard to retirees; AHCCCS; provider networks. The ASRS continues to explore many options of affordable premiums. One option is to study the use of the AHCCCS provider network by the ASRS. Statute does not currently provide the option of AHCCCS' business model regarding provider networks to be offered to retirees. Allowing the ASRS to examine the advantages and disadvantages of using a new management model with AHCCCS could potentially expand ASRS retiree health care choices.

Ms. Gee provided a brief description of other bills that pertain to responsibilities, duties, or authorities of the ASRS that are expected to be proposed by other entities for the 2005 Legislative Session.

Motion: Mr. Jaime Gutierrez moved to direct staff, in accordance with A.R. S. §38-714, to provide technical and administrative information to the Legislature regarding the effect of past

legislation which created the statutory provisions known as the “pop-up/pop-down” benefit and its impact upon the ASRS trust fund, including providing information on any possible legislation.

Mr. Steven Zeman seconded the motion.

By a vote of 7 in favor, 0 opposed, 0 abstentions, and 2 excused, the motion was approved.

Motion: Mr. Gutierrez moved to direct ASRS staff to draft, seek sponsorship and introduction, and realize favorable disposition of appropriate legislation to amend existing statute so that the ASRS may discuss the option of a new management model with AHCCCS for retiree health care.

Mr. Jim Bruner seconded the motion.

By a vote of 7 in favor, 0 opposed, 0 abstentions, and 2 excused, the motion was approved.

10. Director’s Report

No comments.

11. Possible Presentation and Discussion Regarding Board Committee Updates

Mr. Gutierrez, Chairperson, External Affairs Review Committee, stated with the Legislature going into session, there will be future legislation to discuss.

Mr. Lawrence Trachtenberg, Chairperson, Investment Review Committee, stated there will be some discussion with regard to the selection of a small cap growth manager in the future.

Mr. Michael Townsend, Vice-Chairperson, Operations Review Committee, stated that the next ORC is scheduled for November 2004.

12. Board Requests for Agenda Items

None.

13. Call to the Public

None.

14. The next ASRS Board meeting is scheduled for Friday, November 19, 2004, at 8:30 a.m., at 3300 N. Central Avenue, 10th Floor Board room, Phoenix, Arizona.

15. Adjournment of the ASRS Board

Dr. Meredith adjourned the October 15, 2004 Board meeting at 10:58 a.m.

ARIZONA STATE RETIREMENT SYSTEM

Marina Chaves, Secretary

Date

Paul Matson, Director

Date